Separations and Settlements

Access charges did not eliminate AT&T's payments of separations and settlements to local exchange companies. The Federal Communications Commission began soon after divestiture to reconsider that process by which earnings attributed to the recovery of joint and common costs were assigned to interstate or intrastate jurisdictions. The Commission knew that the interstate share of costs had been inflated under the Ozark Plan.[32] Pending reforms, it froze the share of each company's costs that would be attributed to the interstate jurisdiction at 1981 levels; those shares varied across companies from 85 to 25 percent.[33] To reduce the size of the fund requirement to cover common costs, the Commission also required all carriers to contribute to a pool called the "Universal Service Fund" that would be paid out to high-cost companies providing service at averaged rates in low-density locations.[34] This pool was to be funded by various flat-rate and usage-based charges imposed on the interexchange carriers, but particularly from the carrier common line charge.[35]

Separations adjustments along these lines were a limited - compromise. They moved interexchange prices toward costs but maintained price averaging that led to earnings transfers from low to high cost services. Federal Commissioner Anne Jones dissented:

> The days are numbered for regulators who believe they can mandate economically irrational behavior in the telephone industry. It is unrealistic to persist in the belief that dynamic telecommunications markets will adjust to a regulator's transition timetable to preserve "equities" among affected market partic-

31. (...continued)
(1985). The extent of the shift is assessed in share of revenues in the next chapter.

32. Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order, CC Dkt. No. 80-286, 89 F.C.C.2d 1, 4–5 ¶ 7 (1982) [hereinafter *Joint Board*].

33. *Id.* at 4–5 ¶¶ 7–9.

34. *Access Order, supra* note 23, at 278–79, 281–82 ¶¶ 123, 134–37.

35. *Id.* at 283–91 ¶¶ 138–75; NARUC v. FCC, 737 F.2d at 1130.

> ipants. "Equity"-driven policies may be sustainable in a slow-growth, static-technology industry. They are simply not viable in a dynamic growth industry such as telecommunications.[36]

Ultimately, the Commission, supported by state commissioners in low-cost states, sought to end the pooling program but not the subsidies.[37] In early 1987 the joint board of commissions working on postdivestiture policies announced a depooling plan.[38] That body of regulators proposed that line charges would increase and mandatory pooling requirement would be abolished over time.[39] The major carriers were to withdraw from the pool but continue long-term payments to subsidize the carriers remaining in the pool.[40] The Commission agreed not to increase subscriber line charges for residential customers above $3.50 per month. As a result, depooling occurred in 1989.[41]

Under rules in force since 1989, the fund is supported by charges paid by interexchange carriers that use local exchange switches, if the interexchange carriers have 5 percent or more of presubscribed subscriber lines.[42] The charge is a monthly per-line charge and is treated as a specific rate element in access charge tariffs.[43] The local carriers that still participate in the pool all charge

36. Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Dkt. No. 80-286, p.2 (Dissenting Statement of Commissioner Anne P. Jones).

37. MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 50 FED. REG. 939 (Jan. 8, 1985), adopted, 49 FED. REG. 48,325, 48,335-36 (Dec. 12, 1984).

38. MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Report and Order, CC Dkt. No. 78-72, 80-286, 2 F.C.C. Rcd. 2953 (1987) [hereinafter *1987 Retargeting Order*].

39. *Id.* at 2957 ¶ 30.

40. *Id.* at 2957-58 ¶¶ 32-36.

41. TELECOMMUNICATION POLICY, *supra* note 1, at 212.

42. Amendment of Part 69 of the Commission's Rules Relating to the Assessment of Charges for the Universal Service Fund and Lifeline Assistance, Notice of Proposed Rulemaking, CC Dkt. No. 78-72, 80-286, 4 F.C.C. Rcd. 2041, 2042 ¶ 15. (1988).

43. 47 C.F.R. §§ 69.116, 69.117.

the same rates, even though their costs to provide services vary from company to company. Each company receives part of the pooled revenues to cover costs. And the Commission has initiated apparently endless proceedings on pool allocations.[44] In 1993 the Commission noted that the fund had grown from $445 million in 1986 to over $700 million and imposed a cap on future growth.[45] AT&T has complained that it is still paying a disproportionate share; and both the Commerce Department and Congress have considered changes to funding universal service.[46]

State Regulators and Intrastate Toll Rates

Pending court approval of divestiture, the Bell operating companies filed an unprecedented $10.8 billion in local rate increase requests with state public utility commissions nationwide. The companies rationalized those requests as necessary to recover revenue shortfalls that would be caused by changes in payments following divestiture.[47] But also the companies had other reasons for the requests, such as the adoption of accelerated depreciation practices authorized earlier by the Federal Communications Commission.[48] Further, however, the restructuring of the industry itself provided a schedule for phasing in changes in cost recovery practices that increased

44. *See* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, Notice of Inquiry, CC Dkt. No. 80-286, 9 F.C.C. Rcd. 7404 (1994); Amendment of Part 36 of the Commission's Rule and Establishment of a Joint Board, Notice of Proposed Rulemaking and Notice of Inquiry, DD Dkt. No. 80-286, 1995 F.C.C. LEXIS 4697 (July 13, 1994).

45. Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, Report and Order, CC Dkt. No. 80-286, 9 F.C.C. Rcd. 303 ¶ 3 (1993).

46. *Commerce Department Considers Universal Service Proposals*, 2 WASH. TELECOM. NEWS, Dec. 26, 1994).

47. *See* K. GORDON & J. HARING, THE EFFECTS OF HIGHER TELEPHONE PRICES ON UNIVERSAL SERVICE 61 (1984) (FCC Office of Plans and Policy Working Paper).

48. *See* Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, Memorandum Opinion and Order, CC Dkt. No. 79-105, 89 F.C.C.2d 1094 (1982), *reconsid.*, 92 F.C.C.2d 864 (1983), *aff'd sub nom.* Virginia State Corp. Comm'n *v.* FCC, 737 F.2d 388 (4th Cir. 1984); Petition of the State of Michigan Concerning the Effects of Certain Federal Decisions on Local Telephone Service, Order, CC Dkt. No. 83-788, 96 F.C.C.2d 491 (1983); GORDON & HARING, *supra* note 50, at 22–23.

prices but were still acceptable to the regulators and the public.

Divestiture had to have an impact on local rates. The question was, however, the extent of the effect. Assistant Attorney General Baxter took the position that divestiture need not increase local rates.[49] His theory was that there were no earnings transfers from long-distance to local exchange in the separations process—and that even if there were, the Commission could continue to generate the required amount in higher access charges:

> It is not at all clear to me that the fund flow in the direction of the local operating company that results from [the] cost allocation process is substantially more than or perhaps more at all than the funds that flow in the other direction through the license fee contract the [local operating companies] purchase of equipment [from Western Electric] . . . . [R]egulators have the authority to set . . . access charges wherever they choose to set them, and there is not the slightest doubt in the world that if they wish to do so, they can set them high enough to recapture for the local companies precisely those revenues that would have been received through the separations process under the old way of doing things.[50]

These presumptions have been difficult to establish. Earnings from long-distance paid over to local exchange operations came to several billion dollars per year.[51] At the time of divestiture, each minute of long-distance service generated about fourteen cents of subsidy to local service rates.[52] AT&T's tariffs for twenty years

49. TELECOMMUNICATION POLICY, *supra* note 1, at 180.

50. Hearing Before the Sen. Comm. on Commerce, Science, and Transportation, 97th Cong. 61–62 (1982) (testimony of William F. Baxter), *in* TELECOMMUNICATION POLICY, *supra* note 1, at 182.

51. TELECOMMUNICATION POLICY, *supra* note 1, at 182.

52. DAVID M. SAPPINGTON & DENNIS L. WEISMAN, DESIGNING INCENTIVE REGULATION IN THE TELECOMMUNICATIONS INDUSTRY (manuscript) 31 (AEI Press and MIT Press, forthcoming 1996) [hereinafter DESIGNING INCENTIVE REGULATION].

prior had been set to generate high toll price-cost margins, so that net earnings from those services would provide contributions to cover systemwide joint costs and thereby keep down rates on local exchange services. But there have been no findings that showed in the opposite direction excessive payments of the operating companies for AT&T equipment.

Moreover the Commission recognized, should regulators choose to set access charges high enough to continue that transfer of cash flow to local exchange providers, that they faced a significant probability of bypass by large subscribers that built their own long-distance to home office networks. Additionally, one of the anticipated benefits of competition in long-distance markets, that prices would be more in line with direct costs, would not be realized if initial prices were inflated by pass-through of access charges. If local basic residential rates were to continue to be kept down, then contributions would have to come from other market sources. Political pressure was minimized by the adoption of Federal and state "lifeline" programs and the Universal Service Fund to limit the im pact of local rate increases on low-income subscribers.[53] But the burden of responsibility for funding local residential service still was there for state regulators to deal with, given that they were responsible for setting prices in the local exchange and toll service markets.

For the most part, state regulators controlled pricing of intraLATA telephone services.[54] Under the divestiture decree, the country had been divided into 161 LATAs large enough to include both local exchange and long-distance (toll) traffic. State regulators allowed intraLATA toll prices to achieve levels significantly above direct incremental costs while designating the resident Bell operating company the only carrier of intraLATA long-distance traffic.[55] That is, any customer dialing a 1 + long-distance call within a LATA

53. TELECOMMUNICATIONS COMPETITION, *supra* note 44, at 77.

54. *Id.* at 74.

55. Ever since the costs of the local network began to increase markedly relative to the costs of providing long-distance service, "[s]tate regulations have generally chosen to increase rates for special business services, intrastate toll and enhanced services before increasing rates for basic residential local exchange services." *Id.* at 76. *See* National Ass'n of Regulatory Util. Comm'rs, Bulletin 15 (1986).

for completion in that LATA selected the Bell operating company as the carrier of choice. But, as pressures for entry increased over time, the Commissions one by one allowed the long-distance carriers to provide alternative service on intraLATA calls, albeit only after the subscriber first had to dial an extra access code.

Further, state regulators held up the prices charged for intraLATA access.[56] Median intrastate carrier common line charges were about 10 percent lower than interstate charges in 1985, but by 1990 they were twice the interstate charges. Twenty states, mainly those with high rural populations, had charges more than double the interstate average access charge.[57]

Access for AT&T Versus the Other Common Carriers

Before divestiture, the other carriers had paid AT&T for access in originating and/or terminating calls pursuant to negotiated agreements; on average, they paid substantially less for access than AT&T's long lines settlements. The larger carriers such as MCI increased in size relative to AT&T, but their success came from access costs enough lower than AT&T's to compensate for AT&T's advantages from scale and extensive integration. At least one analyst's position was that "MCI's pre-divestiture high profits were mainly the result of its advantageous rates for local access."[58] The proof of that emerged in the year of divestiture, when MCI's profits disappeared with rising access costs and AT&T's new lower price level that resulted from the shift from the settlements to the access charge system:

> During 1984 MCI's gross revenue increased by 30 percent to almost $2 billion, but access costs increased from 17.2 percent of gross revenue in 1983 to 24.5 percent of revenue in 1984. While MCI's access cost was increasing, AT&T's prices were forced down to show consumer benefit from the

56. *Id.*

57. TELECOMMUNICATIONS COMPETITION, *supra* note 44, at 112.

58. TELECOMMUNICATION POLICY, *supra* note 1, at 208.

> access charge plan, and therefore MCI was required to reduce its prices to remain competitive. MCI's pretax profit rate dropped from 18.5 percent of revenue in 1983 to 2.6 percent of revenue in 1984 . . . . By late 1984 MCI stock had plunged to one-quarter of its 1983 high.[59]

MCI was the largest and strongest of the non-AT&T long-distance carriers. Smaller interexchange companies were worse off. It began to appear that not many of these carriers were going to be able to operate in postdivestiture long-distance markets. But then, in the late 1980s, the Commission intervened to ensure that the smaller carriers would not pay as much for access, even for equal access, as did AT&T.

The logic of the Commission's position was based on a new concept of equal access. The obligation of a common carrier to offer other carriers the right to interconnect with its network can be said to follow from common carrier law generally: what it came to was that alternative carriers could be "customers," and when buying carriage, they were entitled to service on nondiscriminatory terms with respect to other customers.[60] In 1971 the Commission had introduced the concept of "equal access" by declaring that monopoly carriers must interconnect with entrants

> [W]here a carrier has monopoly control over essential facilities we will not condone any policy or practice whereby such carrier would discriminate in favor of an affiliated carrier or show favoritism among competitors.[61]

59. *Id.* at 209.

60. FEDERAL TELECOMMUNICATIONS LAW, *supra* note 22, at §12.7.

61. Establishment of Policies and Procedures for Consideration of Application to Provide Specialized Common Carrier Services in the Domestic Public Point-to-Point Microwave Radio Service, First Report and Order, Dkt. No. 18920, 29 F.C.C.2d 870, 940 ¶ 157 (1971); Establishment of Policies and Procedures for Consideration of Application to Provide Specialized Common Carrier Services in the Domestic Public Point-to-Point Microwave Radio Service, Notice of Inquiry, Dkt. No. 18920, 24 F.C.C.2d 318, 347 ¶ 67 (1970).

The consent decree imposed a consistent "equal access" obligation on the divested Bell operating companies by requiring them to provide access "equal in type, quality and price to that provided to AT&T and its affiliates."[62] They were directed to update their networks to provide equal access in virtually all central switching offices by September 1986.[63] Inspired by that commandment, shortly after divestiture, the Federal Communications Commission directed all local exchange carriers to begin the changes necessary.[64] At the time of divestiture, there were no equal access lines. By 1985, 43 percent of lines had been converted. By 1990, 93 percent of lines were converted, including 95 percent of Bell operating company lines.[65] And in 1995 the Commission found that 97 percent of lines had been converted.

The Commission also took steps to ensure equal access to companies that offered "800" and "900" billing services. At one time, any company that wanted to change long-distance companies also had to change its "800" number because routing information was encoded in the number itself; numbers were not "portable" from one carrier to another.[66] In 1991 the Commission concluded that full competition in the "800" market would not develop until numbers were portable.[67] In 1993 the Commission asserted that "with the implementation of 800 number portability, AT&T's 800 services are now subject to substantial competition."[68] The Commission has also taken steps to establish equal access for providers of

62. Modification of final judgment §II(A), *cited in* United States *v.* AT&T, 552 F. Supp. at 225, 227.

63. *See* United States *v.* AT&T, 552 F. Supp. at 233.

64. MTS and WATS Market Structure Phase III, Report and Order, CC Dkt. No. 78-72, 100 F.C.C.2d 860, 861 ¶ 3 (1985).

65. Competition in the Interstate Interexchange Marketplace, Notice of Proposed Rulemaking, CC Dkt. No. 90-132, 5 F.C.C. Rcd. 2627, 2632 ¶ 45 (1990).

66. *See* Provision of Access for 800 Service, Memorandum Opinion and Order, CC Dkt. No. 86-10, 6 F.C.C. Rcd. 5421-22 ¶ 3 (1991).

67. Competition in the Interstate Interexchange Marketplace, Report and Order, CC Dkt. No. 90-132, 6 F.C.C. Rcd. 5880, 5904 ¶ 145 (1991) [hereinafter *Interexchange Competition*].

68. Competition in the Interstate Interexchange Marketplace, Second Report and Order, CC Dkt. No. 90-132, 8 F.C.C. Rcd 3668, 3669 ¶ 10 (1993).

calling cards.[69]

But beyond the open network, the critical step was to invoke the equal charge requirement. The Commission had determined that it would slowly move access charges toward costs. The divestiture decree required this, saying that:

> Each tariff for exchange access shall be filed on an unbundled basis specifying each type of service, element by element, and no tariff shall require an interexchange carrier to pay for types of exchange access that it does not utilize. The charges for each type of exchange access shall be cost justified and any differences in charges to carriers shall be cost justified on the basis of differences in services provided.[70]

But the other carriers believed that they would be disadvantaged if they were to pay equal access charges. They would be paying more than they had paid under the exchange agreements. However, the local Bell operating companies could provide access to AT&T at lower costs than to the other carriers, because AT&T's lines merged with the Bell operating companies' switching facilities, so that AT&T was entitled on cost savings grounds to volume discounts. Even so the decree required the other carriers to pay the same rates for access as AT&T:

> Notwithstanding the requirements of paragraph (2), from the date of reorganization specified in section I until September 1, 1991, the charges for delivery or receipt of traffic of the same type between end offices and facilities of interexchange carriers within an exchange area, or within reasonable subzones of an exchange area, shall be equal, per unit of traffic delivered or received, for all interexchange carriers;

69. *Interexchange Competition, supra* note 73, at 2632 ¶¶ 77–81.

70. Modification of final judgment App. B ¶ B(2), *cited in* United States v. AT&T, 552 F. Supp. 131.

> provided, that the facilities of any interexchange carrier within five miles of an AT&T class 4 switch shall, with respect to end offices served by such class 4 switch, be considered to be in the same subzone as such class 4 switch.[71]

That "equal charge rule" was set to expire in September 1991,[72] and it conflicted with the Commission's Access Charge Order, which proscribed a rate structure for transport charges that reflected the Commission's finding that transport costs were both usage-sensitive and distance-sensitive.[73] Nevertheless, the Commission agreed to waive its rules to permit AT&T and the Bell operating companies to comply with the modification of final judgment.[74]

As the expiration of the equal charge rule loomed, the other facilities-based common carriers demanded relief from the Commission.[75] Sprint claimed that bringing access charges into line with access costs would cause charges to them to rise 10 percent, while AT&T's would fall 6 percent. Sprint emphasized the advantages that volume discounts would give AT&T, simply because "its enormous size over other carriers makes it most likely to have the volumes necessary in any given location to take full advantage of these discounts."[76] AT&T projected that abandonment of the equal-charge rule would give it switched access costs 15 percent lower than mid-sized carriers' access costs and 26 percent lower than smaller carriers' access costs.[77] CompTel complained that AT&T's cost

71. Decree App. B ¶ B(3).

72. Decree App. B ¶ B(3).

73. *Access Order, supra* note 23, at 309, 313 ¶¶ 230, 241.

74. *See* American Tel. and Tel. Co., Petition for Waiver of Sections 69.1(b), 69.3(e), 69.4(b)(7) and (8), 69.101, 69.111 and 69.112 of the Commission's Rules and Regulations, 94 F.C.C.2d 545, 547 ¶ 4 (1983); *Reconsideration Order*, 97 F.C.C.2d at 862 ¶ 88 (waiver extended through May 31, 1985); MTS and WATS Market Structure, Memorandum Opinion and Order, CC Dkt. No. 78-72, Phase I, 50 FED. REG. 9633 ¶ 7 (1985) (waiver extended until further notice).

75. GEODESIC NETWORK II, *supra* note 3, at 3.24–3.26.

76. Reply Comments of Sprint at 6, Expanded Interconnection with Local Telephone Companies, No. 91-141 (FCC Sept. 20, 1991).

77. *See* MTS and WATS Market Structure, Phase I, Order and Further Notice of

(continued...)

advantages would generate incremental operating earnings that would come to $698 million annually, "twice the combined 1988 net income of those AT&T rivals that were profitable that year. That amount is eight times the combined 1988 net income of third tier carriers with revenues in excess of $10 million."[78] CompTel concluded that, without the equal-charge rule, "there is absolutely no possibility of long run competition."[79] Abolition of the equal-charge rule "would wipe out the razor thin margins under which the smaller [long-distance] carriers are doing business these days."[80] CompTel argued that the equal-charge rule could not ever be abolished if AT&T's smaller competitors were to survive—trying to phase out the rule "would result in a slow death rather than a quick death."[81] The Commission in response extended the equal-charge rule temporarily,[82] but ultimately concluded that "the equal charge rate structure cannot remain in place if customers are to receive the benefits of switched transport competition."[83]

Yet in late 1992 the Commission went further in the same direction by requiring access rates that promoted "full and fair interexchange competition."[84] The Commission refused to take any action that could "endanger the availability of pluralistic supply in the interexchange market"[85] and maintained the equal charge system in place from November 1993 to October 1995.

In the end the Commission failed to come up with perma-

77. (...continued)
Proposed Rulemaking, CC Dkt. No. 78-72, 6 F.C.C. Rcd. 5341, 5342 n.15 (1991) [hereinafter *Phase I Order*].

78. Comments and Request for Further Proceedings of CompTel at 33, MTS and WATS Market Structure, No. 78-72 (FCC Feb. 22, 1991).

79. *On Regulatory Front, Smaller Carriers See Major Battles in 1992*, LONG DISTANCE OUTLOOK, Mar. 1992, at 3 (quoting CompTel president James Smith).

80. *Id.*

81. *Id.*

82. *Phase I Order, supra* note 83, at 5344; *see also The Little Guys of Long-Distance Are Mighty Nervous*, BUS. WK., June 3, 1991, at 29.

83. Transport Rate Structure and Pricing Petition for Waiver of the Transport Rules filed by GTE Service Corporation, Report and Order and Further Notice of Proposed Rulemaking, CC Dkt. No. 91-213, 7 F.C.C. Rcd. 7006, 7008 ¶ 2 (1992) [hereinafter *Transport Rate Structure*].

84. *Id.* at 7009 ¶ 5.

85. *Id.* at 7008 ¶ 5.

nent rules to replace the interim rules and extended the October 1995 deadline. It cited Bell operating company estimates that the new rates would lower AT&T's switched access costs by 0.6 percent, would raise mid-sized carriers' costs 0.9 percent, and would raise smaller carriers' costs 1.8 percent.[86] The Commission also found that "[b]ecause total switched access costs account on average for only approximately 40 percent of an interexchange carrier's total costs, assuming the carrier is facilities-based, the impact would be slightly less than half those percentages.[87] The extension *de facto* has established interstate access charges that result in all carriers having the same access charges and thus virtually the same operating costs.

Price Caps on Access Charges

On January 1, 1991, the Commission moved the local carriers' access charges from rate-of-return regulation to the new price cap regulatory process.[88] Price caps were made mandatory for the Bell operating companies and for GTE Corporation. Smaller carriers could choose whether or not to be regulated under a price cap system, but all price cap carriers, voluntary or mandatory, were required to participate on an "all-or-nothing" basis—all affiliates had to enter one or the other system.[89]

Under price caps, the Commission divided the different elements of access into four "baskets," for common-line, traffic-sensitive, special-access, and interexchange access.[90] The Commission capped average price increases in each basket at a maximum equal to the economy-wide inflation rate minus an "*X*-factor" that mea-

86. *Id.* at 7041 ¶ 67.

87. *Id.* at 7042 ¶ 68.

88. Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Dkt. No. 87-313, 5 F.C.C. Rcd. 6786 [hereinafter *LEC Price Cap Order*], and Erratum, 5 F.C.C. Rcd. 7664 (1990), *mod'd on recon.*, 6 F.C.C. Rcd. 2637 (1991) [hereinafter *LEC Price Cap Reconsideration Order*].

89. *LEC Price Cap Order, supra* note 94, at 6789 ¶ 18.

90. *Id.* at 6788 ¶ 14. Service categories are used in the traffic-sensitive basket—(1) local switching, (2) local transport, and (3) information—and in the special-access basket—(1) voice grade/WATS/metallic/telegraph, (2) audio/video, (3) high capacity/Digital Data Service, and (4) wideband data/wideband analog.

sured relative industry change in productivity.[91] The Commission's estimates of productivity for the industry in excess of that for the economy were from -2.6 percent to +6.6 percent per year, but company-to-company productivity varied. The Commission's 1991 price cap plan permitted local carriers to select from a 4.3 percent to a 3.3 percent offset; if the local carrier selected the more challenging 4.3 percent, it could retain more of its profits under a less onerous requirement to share excess net returns with customers.[92]

Within each of the baskets, the Commission further categorized services, and each category had its own pricing constraints ("bands"). Those constraints, which set a ceiling and a floor on specific prices (for most services, the bands were set at plus or minus 5 percent), were designed to prevent the local exchange carriers from compensating for a decrease in one set of prices within a basket by increasing prices on another set.[93] Further, it placed a cap on carrier common line charges that depended not on dollar revenues and costs, but on minutes per line and annual growth of minutes per line.

There were streamlined procedures for approving tariffs in which prices did not exceed the cap and that fell within the bands; such tariffs could take effect without a review proceeding on fourteen days' notice. But local carriers were required to continue to file cost-support data for tariffs outside those constraints.[94]

In 1994 the Commission modified its rules to move transport services[95] out of the basket for traffic-sensitive charges and into a new "trunking" basket for transport and special-access services.[96] The avowed purpose of that change was to limit any local carrier's ability to offset lower rates for more competitive services with higher rates for less competitive services. Then in 1995, the Com-

91. *Id.* at 6796–99 ¶¶ 75–101.

92. *LEC Price Cap Order, supra* note 94, at 6799 ¶¶ 100–02; *LEC Price Cap Reconsideration Order, supra* note 94, at 2641–42 ¶¶ 6–8.

93. *See* 47 C.F.R. §§ 61.41–61.43, 61.45–61.47.

94. *LEC Price Cap Order, supra* note 94, at 6811 ¶ 198.

95. Transport, a component of interstate switched access, consists of local transmission between customer points of presence and local exchange carrier end offices, where local switching occurs.

96. Transport Rate Structure and Pricing, Second Report and Order, CC Dkt. No. 91-213, 9 F.C.C. Rcd. 615, 622 ¶ 12 (1994).

mission announced that the local carriers would have a choice of offset productivity factors of 4.0, 4.7, and 5.3 percent.[97] The local exchange carriers that elected the 5.3 percent factor would not be subject to the sharing requirement. The Commission also announced that it would lower band floors for some service categories.

What are the competitive implications of these changes? During the first three years of price caps, the local carriers kept their access charges at or below the applicable ceilings, implying decreases of $1.5 billion in total charges to the long-distance carriers. Of that total, $373 million was the result of pricing below caps on various exchange service offerings.[98] With productivity advances, access provider's profits increased under price cap regulation. Initial price cap rates were targeted at an 11.25 percent return, and by 1992, the most recent year for which there are estimates, the overall rate of return for price cap local carriers had risen to 12.25 percent, and all price cap carriers earned above 11.25 percent. The most recent access charge filings propose $1.2 billion in further reductions.[99] End-user charges would increase by $13.8 million; carrier common line charges would decrease by $550.8 million; traffic-sensitive charges would decrease by $283.1 million, and rates in the trunking basket would decrease by $388.0 million.

TARIFF SETTING AND ENTRY CONTROL

Before divestiture, statutory powers to license service providers and to require the filing of tariffs had given the Federal Communications Commission the power to determine the number and relative size of carriers in long-distance telephone service markets. First, the Commission could determine who would and would not enter those markets.[100] All common carriers, wire-line or radio-based, fell

97. Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, CC Dkt. No. 94-1, 9 F.C.C. Rcd. 1687 (1994) [hereinafter *1994 Performance Review*]; Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Dkt. No. 94-1, 77 Rad. Reg. 2d (P & F) 783, 819 ¶¶ 198–200 (1995).

98. *1994 Performance Review, supra* note 104, at 1691 ¶ 25.

99. 1995 Annual Access Tariff Filings of Price Cap Carriers, Memorandum Opinion and Order Suspending Rates, 1995 F.C.C. LEXIS 4976 ¶ 2 (July 21, 1995).

100. *See generally* Richard E. Wiley, *The End of Monopoly: Regulatory Change*

(continued...)

within Title II of the Communications Act.[101] Title II includes section 214, the Commission's basic licensing power over common carriers, which barred construction of new lines unless the Commission finds that the additions would serve the public's "convenience and necessity."[102] But there were limits on using that authority to determine what carriers could offer. In 1977 the D.C. Circuit Court review of the MCI application to provide Execunet service (*Execunet I*) specified that the Commission could not retroactively apply conditions on section 214 authorizations to restrict competition.[103] The upshot was that any carrier holding section 214 authorization could offer switched long-distance services in interstate markets.[104]

100. (...continued)
and the Promotion of Competition, in, DISCONNECTING BELL: THE IMPACT OF THE AT&T DIVESTITURE 23, 24 (H. Shooshan ed., Pergamon 1984) [hereinafter DISCONNECTING BELL].

101. *See, e.g.*, National Ass'n of Regulatory Util. Comm'rs *v.* FCC, 525 F.2d 630 (D.C. Cir. 1975) (discussing regulatory scheme adopted for private and common-carriage cellular services). *See generally* FEDERAL TELECOMMUNICATIONS LAW, *supra* note 22, at §12.3.

102. 47 U.S.C. §214(a). Private radio-based carriers must also be licensed, under Title III. 47 U.S.C. §301. *See, e.g.*, Allocation of Frequencies to the Various Classes of Non-Government Services in the Radio Spectrum from 10 Kilocycles to 30,000,000 Kilocycles, 39 F.C.C. 298 (1948); National Rural Telecommunications Cooperative *v.* Southern Satellite Systems, Inc., 7 F.C.C. Rcd. 3213 (1992). Private wire-line networks could perhaps also be licensed by the Commission under its "ancillary jurisdiction," although the Communications Act does not expressly contemplate such networks and the current judiciary may be more hostile to an expansive view of the Commission's ancillary jurisdiction than in the past. "Undoubtedly, private interstate communications services rendered by a common carrier remain within the purview of the Commission, if only pursuant to the Commission's general title I jurisdiction which authorizes Commission regulation that is 'reasonably ancillary' to the exercise of specifically delegated powers under the Act." Southwestern Bell Telephone Co. *v.* FCC, 19 F.3d 1475, 1481 (D.C. Cir. 1994).

103. MCI Telecom. Corp. *v.* FCC (Execunet I), 561 F.2d 365, 374 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978).

104. *Cf.* MTS and WATS Market Structure, Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, CC Dkt. No. 78-72, 81 F.C.C.2d 177 (1980), 93 F.C.C.2d 241, *modified on recon.* 97 F.C.C.2d 682 (1983), *modified on further recon.* 97 F.C.C.2d 834, *aff'd in principal part and remanded in part*, National Ass'n of Regulatory Util. Comm'rs v. F.C.C., 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985).

Even so, the Commission could still determine on what price and service terms common carriers offered their services. Section 203 of the Communications Act required all carriers to file tariffs, or "schedules showing all charges for itself and its connecting carriers."[105] As a general rule, such regulatory oversight as to the prices charged by all providers of long- distance services proved to be cumbersome. The Commission was not able to deal with large numbers of tariff filings; after *Execunet I*, the Commission's response to filings became prolonged and prompted the D.C. Circuit Court to hold that the Communications Act required that "rates . . . be finally decided within a reasonable time encompassing months, occasionally a year or two, but not several years or a decade."[106] Consistent with those developments, in 1980 the Commission ruled that all carriers would henceforth be classified as "dominant" or "nondominant."[107]

Nondominant and Dominant Carriers

In 1980 the Commission ruled that nondominant carriers were those that lacked market power to raise prices, restrict output, or impose unreasonable or discriminatory charges.[108] The Commission stream-

105. 47 U.S.C. §203(a); see also *id.* at § 204 (giving the Commission the power to suspend tariffs); *id.* at §205 (giving the Commission the power to prescribe "just and reasonable" charges and practices if it finds a tariff in violation of Title II).

106. *See* MCI *v.* FCC, 627 F.2d 322, 340 (D.C. Cir. 1980).

107. Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations, Notice of Inquiry and Proposed Rulemaking, CC Dkt. No. 79-252, 77 F.C.C.2d 308 (1979) [hereinafter *Rates Policy*]; First Report and Order, 85 F.C.C.2d 1 (1980) [hereinafter *First Report and Order*]; Further Notice of Proposed Rulemaking, 84 F.C.C.2d 445 (1981); Second Report, 91 F.C.C.2d 59 (1982) [hereinafter *Second Report*], *recon.* 93 F.C.C.2d 54 (1983); Second Further Notice of Proposed Rulemaking, 47 FED. REG. 17,308 (1982); Third Further Notice of Proposed Rulemaking, 48 FED. REG. 28,292 (1983); Third Report and Order, 48 FED. REG. 46,791 (1983); Fourth Report and Order, 95 F.C.C.2d 554 (1983); Fourth Further Notice of Proposed Rulemaking, 96 F.C.C.2d 922 (1984) [hereinafter *Fourth Further Notice*]; Fifth Report and Order, 98 F.C.C.2d 1191 (1984) [hereinafter *Fifth Report*]; Sixth Report and Order, 99 F.C.C.2d 1020 (1985) [hereinafter *Sixth Report*], *reversed and remanded sub nom.* MCI Telecommunications Corp. *v.* FCC, 765 F.2d 1186 (D.C. Cir. 1985).

108. *First Report and Order*, *supra* note 114, at 20–21 ¶¶ 15–16.

lined regulation of nondominant carriers by reducing the ninety-day notice of a tariff filing to fourteen days. The presumption was that the Commission would not investigate or suspend the tariffs.[109]

In 1982 the Commission adopted a policy of "forbearance" for some nondominant carriers, by which it declined to require them to file tariffs under section 203 or to comply with section 214.[110] After divestiture in 1984, the Commission extended that policy to all domestic nondominant carriers[111] and by 1985 the Commission decided that they should not be required to file any tariffs.[112] The grounds for this new policy was that the Commission was concerned that its tariff-filing requirements could facilitate collusive pricing,[113] a prospect reduced by allowing nondominant carriers to keep their prices confidential.[114] MCI, a non-dominant carrier, objected to not submitting tariffs[115] and the D.C. Circuit Court overruled the Commission in a decision that found that the Communications Act left the Commission with no discretion to "prohibit the filing of tariffs that, by statute, every common carrier shall file."[116] But a second D.C. Circuit Court opinion in 1992 overruled the Commission's decision to exempt nondominant carriers from tariffing requirements.[117] The Commission then made it clear that it intended to streamline tariffing for nondominant carriers as much as possible, so that, since 1993, whenever a nondominant carrier filed a tariff it became effective in one day.[118]

Those decisions left AT&T in a class of tariff regulation by itself. In 1979 the Commission ruled that AT&T would be treated

109. *Id.* at 35-38 ¶¶ 102-11.

110. . *Second Report, supra* note 114, at 73 ¶ 5.

111. *Fifth Report, supra* note 114, at 557 ¶ 10.

112. *Fourth Further Notice, supra* note 114, at 923-24 ¶ 1; *Sixth Report, supra* note 114, at 1034 ¶ 11.

113. *Sixth Report, supra* note 114, at 1030-32 ¶ 18

114. *Sixth Report, supra* note 114, at 1034 ¶ 23.

115. *Sixth Report, supra* note 114, at 1020 n. 9.

116. MCI *v.* FCC, 765 F.2d at 1186 (1985).

117. AT&T *v.* FCC, 978 F.2d 727 (D.C. Cir. 1992).

118. Tariff Filing Requirements for Nondominant Common Carriers, Notice of Proposed Rulemaking, CC Dkt. No. 93-36, 8 F.C.C. Rcd. 1395 ¶ 13 (1993). In addition, later *See* 47 C.F.R. *See* 47 C.F.R. §61.23(c); Tariff filing Requirements for Nondominant Common Carriers, Memorandum Opinion and Order, C 1395 ¶ 3 (1993) [hereinafter *Tariff Filing Requirements for Nondominant Common Carriers*].

as a "dominant" carrier, and so would not enjoy the streamlined regulation applied to MCI and Sprint.[119] The Department of Justice may have assumed that divestiture would change that. The Commission, however, refused to adopt a policy of streamlined regulation for AT&T after divestiture.[120] In 1989 when the Commission replaced rate-of-return regulation for AT&T with price caps, AT&T was still the "dominant" interexchange carrier.[121] In 1993 AT&T petitioned the Commission to be reclassified as a nondominant carrier, saying that it lacked the market power that would still justify restraint under existing regulation.[122]

AT&T's unique position was eliminated when the Commission unanimously granted that petition on October 12, 1995.[123] AT&T was freed from most price cap regulation, was allowed to file tariffs on one-days' notice, no longer was required to report carrier-to-carrier contracts, was authorized to extend service to any domestic point, and did not have to meet the requirement to submit cost support data for proposed rate changes. The Commission found that AT&T lacked "market power in the

119. *See, e.g.*, Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, CC Dkt. No. 87-313, 4 F.C.C. Rcd. 2873, 2887–88 n. 197 (1989) [hereinafter *Rates for Dominant Carriers*]; *Interexchange Competition, supra* note 73, at 5903 ¶ 30; Remarks of Alfred C. Sikes, Commission Chairman, Feb. 15, 1990 (1990 F.C.C. LEXIS 862) ("Today, AT&T . . . [is] still required to file voluminous data, to get permission before it offers many price discounts, and, among the interstate carriers, its regulatory treatment remains unique.")

120. *Interexchange Competition, supra* note 73, at 5903 ¶ 30; Policy and Rules Concerning Rates for Dominant Carriers, Memorandum Opinion and Order, CC Dkt. No. 87-313, 6 F.C.C. Rcd. 4819 (1991).

121. *See, e.g., Interexchange Competition, supra* note 73, at 5903 ¶ 30; *Rates for Dominant Carriers, supra* note 127, at 2943, 2996; Policy and Rules Concerning Rates for Dominant Carriers, Further Notice of Proposed Rulemaking, CC Dkt. No. 87-313, 3 F.C.C. Rcd. 3195, 3235–36 (1988) [hereinafter *Rates Further Notice*].

122. Motion for Reclassification of American Telephone and Telegraph Company as a Non-Dominant Carrier, CC Docket No 79-252, September 22, 1993 (hereafter "AT&T Motion"). See also AT&T April 24, 1995, *Ex Parte* Filing.

123. Motion of AT&T Corp. To Be Reclassified as a Non-Dominant Carrier (hereafter "Nondominance Order"); CC Docket 95-427; October 13, 1995. AT&T's request to be reclassified as a nondominant in regards to the provision of international services was deferred to another proceeding.

interstate, domestic, interexchange market."[124] Two arguments marked this finding. The first was the broad definition of AT&T's market; the second was the rejection of price leadership as a pattern of behavior to be associated with dominance. In the nondominance order, the Commission found that all interstate, domestic, interexchange telecommunications services comprise a single relevant product market relevant for determining if a carrier had "(sufficient) market power. . .to control prices."[125] The Commission did not explain but "agreed with AT&T that in this case we should use the all interstate domestic interexchange services market definition" previously adopted.[126] This definition allowed the Commission to conflate revenue share across different home and business service markets to arrive at a judgment of lower AT&T share. The Commission also noted that AT&T's residential rates fell between 15 and 28% in nominal terms, and took this, and the availability of numerous discount plans, as evidence of pricing competition. Even more striking, the Commission used a definition of market dominance that recognized dominance only when there was a one-firm monopoly. The Bell operating companies submitted evidence that cooperative pricing had rendered the industry a three-firm non-competitive oligopoly, in which AT&T, MCI, and Sprint coordinate price changes.[127] Although the Commission recognized this characterization, they found that the evidence was "conflicting and inconclusive as to the issue of tacit price coordination." To the extent the condition did exist, however, it would be "a problem generic to the interexchange industry and not specific to AT&T" and "because they relate to the industry as a whole, these issues do not preclude our concluding that AT&T lacks the power to raise residential prices unilaterally above competitive levels." No carrier now has dominant status.

The Shift to Price Cap Regulation

At the time of divestiture, AT&T was subject to public utility

124. *Id.* at ¶ 74.
125. *Id.*
126. *Id.* at ¶ 21.
127. *Id.* at ¶ 81.

regulatory practices and procedures of both state and federal agencies. The company submitted cost studies to support requests for tariff rate changes. It was allowed to charge consumers enough to recover operating and capital costs, plus a reasonable return on its investments.[128] After a half century of rate cases, the problems with rate-of-return regulation were well known; limiting revenues to "costs of service" generated inefficient investments so as to increase total earnings and reduce incentives to hold down staff and line employment.[129] Even more basic, the system proved to be a force for expanding capital-intensive local services and subsidizing those services with earnings on long-distance services.

Price cap regulation developed as the alternative to rate-of-return regulation in the post-divestiture decade in all the regulated industries. Under the new system, regulators chose a price level (essentially the current level) and then in succeeding years applied a percentage change determined by an inflation index net of a relative productivity growth index. The telephone company under those rules could increase its earnings by controlling costs and increasing productivity at a higher than index rate.[130]

In May 1989 the Commission adopted a system of price caps for AT&T,[131] the "dominant" interexchange carrier,[132] that would take effect in July 1989.[133] The Commission had determined that AT&T should have more pricing flexibility to respond to the pricing initiatives for share gain by the entrant carriers.[134] New - price cap tariffs would take effect on July 1 of each year, after a forty-five-day notice period (later reduced to fourteen days for in-band rates). The Commission was actually rather slow in adopting

128. FEDERAL TELECOMMUNICATIONS LAW, *supra* note 22, at § 9.2

129. The theory of excess capitalization was developed in H. Averch and L.L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 AM. ECON. REV. 1053 (1962).

130. *Id.*

131. *Rates for Dominant Carriers, supra* note 127, at 2877 ¶ 3.

132. *See, e.g., Interexchange Competition, supra* note 73, at 5903 ¶ 30; *Rates for Dominant Carriers, supra* note 127, at 2943 ¶ 133, 2996 ¶ 238; *Rates Further Notice, supra* note 129, at 3235–36 ¶ 69.

133. *Rates for Dominant Carriers, supra* note 127, at 2876 ¶ 3.

134. *See, e.g., Rates for Dominant Carriers, supra* note 127, at 2893 ¶ 37, 2922–24 ¶¶ 100–05, 2939–43 ¶¶ 125–33.

the new procedure. State commissions had already provided full pricing flexibility for AT&T for interLATA services in thirteen states, while commissions in sixteen more states had begun to allow prices to move within specified ranges without cost-based rate proceedings. Commissions in six more states allowed partial pricing flexibility for AT&T's MTS or WATS services.[135] Most states had reduced notice periods for rate changes, from ten to thirty days, with some differing by the direction of the change (for example, thirty days for increases, one day for decreases).

The Commission not only lagged behind, but also did not adopt a pure price cap plan. Instead, it separated AT&T's services into "baskets." At first, the Commission suggested a single basket,[136] then two baskets—one for public switched services and one for private-line services.[137] Ultimately, however, responding to competitor's fears, it established three baskets.[138] Basket one was to apply full caps to services for small business and residential subscribers ("the grandma basket"). Basket two was for 800 services (inbound WATS). Basket three was for AT&T's other business services such as outbound WATS and virtual network services, used mainly by large business customers and thus most often targeted by competitors.[139] For each basket, the Commission established a price cap index representing a weighted average of the actual prices to be charged for services. The company could change rates for services within each basket if the weighted average of all prices remained below the index.

The Commission further subdivided the baskets into service categories and set a ceiling and a floor index price for those service categories that established the acceptable price "band"[140] limiting

135. *Id.* at 2927 n. 183, 2930 ¶¶ 109–10.

136. Policy and Rules Concerning Rates for Dominant Carriers, Notice of Proposed Rule Making, CC Dkt. No. 87-313, 2 F.C.C. Rcd. 5208 (1987).

137. *Further Rates Notice, supra* note 129, at 3352–53 ¶ 280.

138. *Rates for Dominant Carriers, supra* note 127, at 2897 ¶¶ 48–51.

139. *Rates for Dominant Carriers, supra* note 127, at 2897 ¶¶ 48-51. *See* TELECOMMUNICATION POLICY, *supra* note 1, at 272.

140. Policy and Rules Concerning Rates for Dominant Carriers, Memorandum Opinion and Order on Reconsideration, CC Dkt. No. 87-313, 6 F.C.C. Rec. 665, 666 ¶ 8 (1991) [hereinafter *Rates Reconsideration*]; *Rates for Dominant Carriers, supra* note 127, at 2898 ¶ 52.

the range within which AT&T could raise or lower prices for individual service elements in each category. For instance, the residential service average rate could not increase by more than 1 percent per year relative to the change in the index,[141] although the Commission recently authorized an exception to that limit.[142] The upper and lower bands allowed movement of around 5 percent for most service categories.

The purpose of the separate baskets and bands was to "isolat[e] less competitive services" to "prevent their use as a source of cross-subsidies," and to "discourage predation."[143] The Commission seemed particularly concerned that AT&T would drop its prices below the floors specified in the bands and warned that it would guard against "precipitous price decreases" that might have an "anticompetitive effect."[144] The Commission also took the position that it would disallow price decreases within the bands if they were anticompetitive under "relevant antitrust analysis."[145]

The Commission emphasized that the move to price caps still constrained AT&T's ability to engage in "anticompetitive pricing actions"[146] such as predatory pricing.[147] It explained that the service bands would "address any residual concerns about price manipulation by AT&T detrimental to its competitors"[148] and would "provide protection to [AT&T's] competitors from injurious pricing actions."[149] Protecting competition meant protecting competitors.[150]

Ceiling prices under the plan took AT&T's existing rates as

141. *Rates for Dominant Carriers, supra* note 127, at 3054 ¶ 364.

142. AT&T Corporation's Petition for Waiver of Section 61.47(f)(2) of the Commission's Rules, Order, 1995 F.C.C LEXIS 4262 (June 29, 1995).

143. *Rates for Dominant Carriers, supra* note 127, at 3065, 3056 ¶ 368, ¶ 387.

144. *Rates Reconsideration, supra* note 143, at 666 ¶ 8; *Rates for Dominant Carriers, supra* note 127, at 3111–12, 3114 ¶ 390.

145. *Rates for Dominant Carriers, supra* note 127, at 3115 ¶ 389.

146. *Rates for Dominant Carriers, supra* note 127, at 2941 n.238; *Rates Reconsideration, supra* note 143, at 669 ¶ 32.

147. *Rates Reconsideration, supra* note 143, at 667; *Rates for Dominant Carriers, supra* note 127, at 3066 ¶ 389.

148. *Rates for Dominant Carriers, supra* note 127, at 3059 ¶ 374.

149. *Rates Further Notice, supra* note 129, at 3355 ¶ 285.

150. *See, e.g., Rates Further Notice, supra* note 129, at 3200–01 ¶ 6; *Rates for Dominant Carriers, supra* note 127, at 2886 ¶ 25, 3065–66 ¶¶ 387–91.

a starting point.[151] AT&T was permitted to raise prices by the gross domestic product inflation rate,[152] but only after that rate was reduced by a "productivity offset" factor of 2.5 percent.[153] The Commission also required the rate to be decreased by an additional 0.5 percent "consumer productivity dividend," intended to cause AT&T to pass along cost savings from some part of its own higher level of increased efficiency.[154] To monitor AT&T's compliance with that plan, the Commission required AT&T to file annual price cap tariffs.[155] The Commission did not prohibit tariffs that deviated from price bands but did subject them to regulatory scrutiny for potential adverse effects on competitors.[156]

That procedure established that AT&T set "posted" prices for all classes of service that could be used as the benchmark for *pro forma* tariffs then submitted by the other carriers. Then other carriers could not then chisel that price schedule with discounts to gain share. The benchmark allowed responses by AT&T that could make chisels unprofitable; AT&T could legally react to other suppliers' lower rates by putting through responsive cuts if they were within a specified range of the average rate for that basket of services. The range for AT&T was broad; for example, basket one had six service categories consisting of (1) domestic day, (2) domestic evening, (3)domestic night/weekend, (4) international MTS, (5) operator and credit card services, and (6) the "discount" Reach Out America service. AT&T could decrease rates for those categories by 5 percent per year, after adjusting for the percentage change in the price cap index, which could further reduce price by 5 percent or more.[157] Thus, AT&T could put in place a substantial rate response—a cut of 10 percent or more—without having to provide notice, at least in selected categories, where shares were

151. *Rates for Dominant Carriers*, *supra* note 127, at 3084–89 ¶¶ 424–30.

152. *Id.* at 2969–74 ¶¶ 186–97

153. *Id.* at 1989–97 ¶¶ 221–39.

154. *Id.* at 2894, 3001 ¶ 249.

155. *Id.* at 3093 ¶ 440.

156. *See, e.g.*, *Rates Further Notice*, *supra* note 129, at 667 ¶ 15; *Rates for Dominant Carriers*, *supra* note 127, at 3065–66 ¶¶ 387–89.

157. A 4 percent rate of change in the cap applied to domestic evening and domestic night/weekend. *Rates for Dominant Carriers*, *supra* note 127, at 3054 ¶ 364.

prominently spread among the three largest carriers. While tariffs prevented "predation" they had in place the flexibility to warn the smaller carriers against strategic discounting to shift market share.

At the same time, as part and parcel of these complicated trigger mechanisms, as AT&T submitted tariffs, other carriers could respond before they took effect. This process precluded any competitive gain for AT&T from an own price reduction initiative. The what and when in the tariffs of the largest carrier established discipline in the price-change practices of all three large carriers.

The Commission decided that it could provide even more flexibility in tariff setting for business service offerings. In 1990, it announced that because services "at the high end of the market . . . [are] the most vigorously competitive," it would limit the control process over prices for those services.[158] In 1991 the Commission found that "the public interest would best be served by more limited advance review of AT&T's business service filings, including the complaint process and our authority to initiate investigations and find tariffs unlawful after they take effect."[159] In November of that year the Commission eliminated basket three caps and replaced them by rates with automatic fourteen-day approval (except for those involving service on analog private lines).[160] The Commission allowed AT&T to offer those business services by private contract rather than by tariff, although the company still had to file the contract terms fourteen days in advance.[161] The contracts had to comply with Communications Act requirements, such as the "reasonable rates" requirement and the prohibition on discrimination.[162] In May 1993 it eliminated price caps on basket two services, except for 800 directory service. Citing "substantial" competition, the agency moved commercial long-distance services remaining in basket one out from price cap regulation in January 1995.[163]

158. *Interexchange Competition*, *supra* note 73, at 2628 ¶ 2.

159. *Id.* at 5882 ¶ 9.

160. *Interexchange Competition*, *supra* note 73, at 5894 ¶ 73. Basket three holds ProAmerica, WATS, Megacom, SDN, other switched services, voice grade and below private line service, and other private line service. *Id.* at 5881 & n.4.

161. *Id.* at 5897 ¶ 72.

162. *Id.* at 5897 ¶ 91, 5902–03 ¶¶ 126–28

163. Revisions to Price Cap Rules for AT&T Corp., Report and Order, CC Dkt.

(continued...)

Even so, the Commission held the position for ten years that AT&T was still a dominant carrier. Unlike Sprint, MCI, and other smaller carriers, whose tariffs could become effective on one day's notice, AT&T had to subject its tariffs to "advance review" by the Commission.[164] The Commission reserved the right to "suspend and/or reject tariffs where necessary" even after those tariffs had taken effect.[165]

FACILITATING COLLUSION

In markets with two or three large-sized suppliers, the sales and revenue levels of any one depend on the actions of the others as to pricing of services. One such carrier would have to be aware of others' prices and anticipate others' reactions to its price offerings in the tariffs. There are quite different ways, however, in which these providers could interact.

The threshold assumption is that they act collectively to set rate levels that increase market revenues. They would cooperate, or make adjustments to each other's presence short of cooperation, to set a commonly advantageous price level. But this holds only if each is assured that none of the others adopts price cutting as an initiative to gain market share.

Regulatory procedures in place after 1984 in long-distance markets have been of the type that assist in the (informal) adoption of such an approach. Tariff submission processes favored acceptance of AT&T's tariffs as the benchmark. Over time, the three large facilities-based carriers, AT&T, MCI, and Sprint, issued tariffs with pricing terms that became more publicly identical.

Signaling

The Commission was well aware that its tariffing process had the potential to be used by one carrier to signal others what its prices would be before actually charging those prices. Since the early

163. (...continued)
No. 93-197, 10 F.C.C. Rcd. 3009–11, ¶ 5 (1995).

164. *Interexchange Competition*, *supra* note 73, at 5882 ¶ 9, 5893–94 ¶ 72.

165. *Id.* at 5894 ¶ 74.